March 30, 2005

Mr. Gary M. Jackson
SBA Assistant Administrator
 for Size Standards
409 Third Street, SW
Washington DC 20416

Re: **RIN 3245-ZA02**

Dear Mr. Jackson:

The National Minority Supplier Development Council Inc, (NMSDC) is a minority business organization that seeks to provide opportunities for minority for minority businesses both in the public and private sector. We are committed to leveling the playing field and ensuring equal access and opportunity for small and minority businesses that are doing business with the Federal Government as both Prime Contractors and Subcontractors.

NMSDC, a partner in the Minority Business Summit Committee (MBSC), assisted in convening a Size Standard Response Committee and has held a series of public forums concerning this important issue. The consortium, which convened, unanimously concluded that SBA's initial size standard proposal was unrealistic and would have disastrous effects for small and minority businesses. We appreciate the opportunity to provide a response to the Size Standard Advance Notice of Proposed Rule Making (ANPRM). However, in order to develop a more permanent solution, a more appropriate approach would be to retain economists, other experts and representatives of the small business community to assist SBA in drafting an amended Size Standard Proposal. We will be contacting you to further discuss this matter.

There are over 23.7 million small businesses in the United States and the Small Business Administration (SBA) Office of Advocacy estimates that 600,000 of these American businesses are doing business with the Federal Government. In addition, according to the U.S. Census Bureau, over 50% of America's Gross Domestic Product (GDP) is generated by small businesses.

Notwithstanding the tremendous contribution that small businesses add to the US economy, the Federal Government as a buyer of goods and services has implemented policies that have not only hindered the growth of the small business sector, it has established barriers for participation in the Federal procurement process that has almost destroyed whole sectors of small business participation, especially for minority owned small businesses.

Nevertheless we offer the following recommendations:

Despite allegations to the contrary, we does not believe current size standard policies are confusing or fraught with complexity. We do believe that the current regime of size standards, regardless of industry, is significantly below the level necessary to develop competitively viable companies, which is the standard that we believe SBA should encourage.

Businesses of all sizes should share in the opportunity to win and execute contracts with the federal government and that the opportunity should never be diminished. We will offer suggestions as to how the government might allocate contracting opportunities based upon a company's size near the end of this letter. Without carving out contracting opportunities for small businesses of all sizes, it is likely that only large businesses would ever be able to obtain and execute government contracts. Large businesses are able to exploit economies of scale and the economies of influence much more effectively than their small business counterparts.

Our society and social character is improved immeasurable when small companies are included and afforded a chance for a better future as a result of the beneficial economies of participation in real and substantial contract opportunities. With a solid business foundation, contractors are able to provide competitive, cost effective and innovative services and products to its customers. The government's case against Microsoft demonstrates its understanding that true innovation and customer service comes from many businesses competing at all levels rather than a just few monoliths controlling the outcomes of us all.

Size standards and the small business program were created to provide an environment where small business could grow and become competitively viable. A small company's viability in an open competitive marketplace is a function of scale when facing competition from much larger companies. Scale corresponds to a company's ability to recover the indirect costs at the billing rates that bidders have proposed. If volume is too low, companies will either lose money or cut their infrastructure (decreasing their long-term potential) or both. If volume is adequate or higher than expected, companies will either make money or increase their infrastructure (increasing their long-term potential) or both. Until a small business firm reaches the necessary level of sales, small businesses cannot afford an adequate infrastructure to face larger company competition. Adequate infrastructure means a small business firm would need to have sufficient sales volume to cover the cost of that infrastructure. Competition holds down the General and Administration (G&A) rates, which, as a result, may not cover all core indirect operating costs. G&A rates include a company's sales, human resources, quality assurance and finance and administration department. The volume of contract activity as well as the intensity of the competition determines the affordability of core operating expenses that are critical to operate a company and be sufficiently viable to compete effectively.

Size Standard Solution

Our proposed solution to the size standard issue is incorporated in the " **5-10-5"** formula. The formula is simple and is as follows:

1. Identify the five (5) top corporations in each industry;
2. Take the total gross revenues (public and private sector) and determine the average revenue of those corporations over the last 5 years.
3. Take 5% of that average revenue and it becomes the top level of a 5-tier small business structure (20% per tiered level with the largest firms at the 5% average of the largest corporations identified) for the Small Business Administration to serve and support.
4. Associated with the tiers structure would be employee size standards at the following thresholds: 1500, 1000, 500, 300, 150.

In addition to the 5-10-5 Formula, please review our recommendations concerning other ANPRM issues.

Grandfathering

An effective grandfathering date could be crafted in a myriad of ways, but here are 2 suggestions for you to consider:

1. Effective for solicitations issued after the beginning of the next federal fiscal year.

2. Effective after three years for companies with a primary NAICS code that has a revenue-based size standard. Effective after one year for companies with a primary NAICS code that has an employee-based size standard.

Impact on Other Federal Programs

The focus here should be on programs outside of 8(a), SDB and HUBZone.

1. SBA 7(a) loans made to retail establishments could suffer if there is a move to employee-based size standards. The retail industry depends heavily on part-time help and it would be difficult to change from a revenue-based to an employee-based size standard. If retail establishments become other than small, many will lose eligibility for 7(a) loans.

2. There are concerns that a switch to employee-based size standards would stunt job growth.

3. There may be an impact of a change in size standards on state small business programs.

4. Other agencies should not have to go to the SBA for an exemption from size standards for laws or regulations outside of the procurement arena.

5. If other agencies are not required to get consent from SBA for an exemption, will this harm small business?

<u>Size Affiliation</u>

1. **The role of VCC financing on SBIR projects during Phases I and II.**

   There is a concern that an ill-conceived program and policies could lead to small and minority businesses being manipulated and controlled by venture capital companies (VCC) and other larger entities which recognize the value of investing in small minority owned business. A small minority owned business would expect to have access to equity capital, through this initiative, allowing for growth and expansion of its business. On the other hand, a venture capital company (VCC) would rightful expect an appropriate return on investment with said small or minority owned business.

   Our committee would recommend the establishment of criteria for institutional investors, which might want to participate as a result of this policy change. Issues related to amount of equity needed to secure the investment, with the small business owner(s) maintaining control and management of the business are critical. There should also be some boundaries or parameters established as it relates to safe guarding the investors monies without providing undue influence or authority over the business. NMSDC proposes that only institutional investors be allowed to participate, since they are less likely to attempt to manage or direct the small minority business in its development. We would strongly encourage SBA to look at the NMSDC "Growth Initiative" for criteria which might be useful.

2. **What is the impact of such a change in eligibility requirements would have on the composition of SBIR participants. For example, would the program shift towards lower-risk technologies closer to market, or become more geographically concentrated following industries and**

areas of venture capital focus?

There is no way to tell the geographical impact of approving this initiative or whether lower-risk or higher-risk companies would benefit more. The intent should be to promote as diverse a funding opportunity by industry, geography, gender and ethnicity as possible.

3. **What types of firms and projects would benefit most from such a change, and which would benefit the least**.

We believe that businesses with strong leadership, desired products or services and a clear vision are likely to be the greater beneficiaries. Information technology companies in all their aspects (data handling, security, systems analysis, etc.) are likely to gain the most from funding aspects of this proposal. The converse is also true. Companies still feeling their way will find themselves unable to benefit from this funding stream and possibly vulnerable to manipulation and control from larger more experienced companies which see the strategic potential and commensurate risks.

SBA should consider incentives for VCC's which provide equity capital in less attractive industries to promote growth and innovation in more traditional industries. Professor Timothy Battle, Wayne State University, has completed a study which showed the return on investment from small minority business was the same as for majority owned businesses financed through venture investment. The fact is that it is not a bigger gamble to invest in small minority-owned businesses than similar sized majority owned businesses.

4. **Indicate whether an exclusion from affiliation for VCCs would require justifying limiting the exclusion to VCCs and not including other entities such as not-for-profit organizations**.

Again, we would recommend that if this program is undertaken that criterion be established for VCCs and not-for-profit business. With not-for-profit organizations, SBA should be clear regarding their leadership; mission and any other considerations which communicate what can and cannot be done through this structure.

5. Indicate whether or not granting VCC exclusion from affiliation would adversely affect the ability of small business concerns without such access to private capital to compete for SBIR awards.

The determination of whether this will adversely affect small minority business will be the result of how the program is designed and monitored. Small businesses need access to the funds but do not need to have a program developed which could make them more vulnerable to take over or manipulation by larger entities with more money than scruples. Proof of the pudding is in the eating and proof of the program will be in its design and implementation.

6. Whether the participation of firms owned and controlled by VCC firms would ultimately create an environment of multiple repeat award winners.

The design of this program should ensure there is not an opportunity for a VCC or VCC's to control any industry by trying to invest in a disproportionate number of small minority businesses in a particular industry. SBA may want to establish a number or percentage, of small or minority businesses, any one VCC or consortium of VCCs can invest in, by industry**.**

7**. Identify the alternative approaches that may assist small business concerns in obtaining and utilizing VCC funding while participating in the SBIR Program, aside from a policy that requires an exclusion from affiliation for VCC majority-owned small business concerns.**

Our strongest recommendation is that SBA establishes criteria for VCC which would participate under this initiative. Likewise, the establishment of criteria for interested small minority businesses would protect the integrity of the program. For example, SBA might want to require that small business and small minority businesses are first qualified or certified before they could recruit VCC partners. It might also be wise to have some process for reviewing the VCC deal proposed to ensure the arrangement passes some review and was entered into with the intent to supports the growth and development of small businesses. Again, a review of the NMSDC "Growth Initiative" would be very useful.

8. **Therefore, SBA is also seeking comments on the costs to small entities if SBA implements a rule that would provide an exclusion from affiliation for VCC companies in size determinations for eligibility for the SBIR Program. Such costs include implementation costs and the effect the rule would have on profits or revenues, i.e., whether it would it reduce profits or raise or lower revenues. Comments on any other aspect of the SBIR Program that might directly affect whether or not SBA should propose excluding VCCs from affiliation for purposes of the SBIR Program are also welcome.**

9. **With respect to the issue of franchising, while not yet impacting our group's sector (as it has the medical technology field), it is one that needs to be noted**.

If franchisees are allowed to compete, it will be detrimental to small business by infringing on small business set-asides. Franchisees have the ability to call upon the capacities and facilities of the parent company which gives them an inherent leg up on their counterparts that are stand-alone entities.

SBA is strongly encouraged to look at similar programs, both in the public and private sector, and review for best practices and not reinvent the wheel during the program development process. The National Minority Supplier Development Council (NMSDC) could share information on its "Growth Initiative" Program that has some similarities with your activities.

The following document provides more rationale for the multi-tiered approach supported by NMSDC.

I. White Paper
On
Multi-Tiered Size Standards

Tiered Size Standards Team

This paper sets forth the idea that SBA's Size Standards could be modified with respect to certain NAICs Codes to utilize a multi-tiered approach that would accomplish two important objectives:

1. More realistically reflect the size that certain small businesses need to reach before being classified as large businesses
2. Establish competition among small businesses of roughly similar size to compete against each other for government contracts.

This White Paper is the result of deliberations and consultations by the small and minority businesses that signed up for the Tiered Size Standards Team at the January 4th meeting of the Size Standards Coalition organized by ABST and the Minority Business Summit.

This draft is prepared for discussion purposes by the participants at the January 13th Size Standard Coalition meeting.

This paper is divided into three sections:

Section I - Multi-tiered size approach to size standards in the IT services industry
Section II - Presents arguments for and against multi-tiered size standards
Attachments - Presents the comments received by LAMA from interested companies

This document was prepared by Stephen Denlinger, Pres/CEO, Latin American Management Association, Federal Procurement Advocate, U.S. Hispanic Chamber of Commerce with input from numerous participants on the Tiered Size Standards Team.

Multi-tiered Size Standards

Abstract

This paper discusses the idea that SBA's Size Standards could be modified with respect to certain NAICs Codes so as to:

1. **More realistically reflect the size that certain small businesses need to reach before being classified as large businesses**
3. **Establish competition among small businesses of roughly similar size to compete against each other for government contracts.**

<u>Section I</u>.

Multi-tiered Size Standards - IT Services Industry

Inadequate Size Standards - Certain size standards that SBA uses to determine when a small business becomes a large business are totally inadequate. The reason SBA's size standards for such industries are inadequate is that they do not even remotely represent the size that the average small business should be in a particular industry.

Information Technology services industry (not including computer hardware) is an example of an industry wherein the size standards established by SBA for determining when a small business becomes large business are totally inadequate. The size standard that SBA has applied to the IT services industry does not adequately protect the interests of small IT companies in the Federal marketplace.

SBA's IT Size Standard - According to the SBA's size classification system, small businesses in the information technology (IT) services industry become large businesses when annual sales exceed $21 million (three year average). SBA established this size standard despite the fact that medium-sized businesses in the IT industry have annual sales in the **hundreds of millions of dollars**, and large businesses in the IT industry have annual sales in the **billions of dollars**.

$21 Million vs. $6 Billion - Medium-sized firms in the IT services industry to have sales in the **<u>hundreds of millions of dollars</u>** per year. Large firms in the IT services industry have sales in the **<u>billions</u>** of dollars per year. Computer Sciences Corporation, for example, had $6.6 <u>billion</u> in sales in 1998.

A small IT firm, with annual sales of $21 million, is still an astonishingly small company in the overall IT industry. Upon exceeding the size standard of $21 million, these extremely small firms are cast out to compete in the IT industry with companies that have sales that are anywhere from ten times to three hundred times their size.

SBA's IT size standards put very small IT firms in the extremely unfair position of competing against firms that have annual sales in the hundreds of millions to billions of dollars. It is extremely unfair to classify small IT firms as large business when they reach $21 million in annual sales. It is an example of the agency that is chartered by the U.S. Congress to protect small businesses - SBA - is not doing so.

Unfair Competition - How can small IT firms, which become large businesses when they reach $21 million in annual sales, compete against large firms having hundreds of million or billions of dollars in annual sales? The answer is ... not very well. They do not have the infrastructure, resources or the track record necessary to compete against firms that have hundreds of millions to billions of dollars per year in sales. The playing field is not level. In fact, it is grotesquely tilted in favor of large business.

How is this Possible? - The enormous disparity between the size of small businesses that SBA determines to have become large businesses (three-year average sales of $21 million) and the middle-sized and large businesses in the IT marketplace occurs because the **SBA only has a one-tiered small business classification system**. SBA's single small business tier in the IT services industry is comprised of companies that have from $zero to $21 million in annual sales.

The threshold of $21 million, beyond which small IT companies become classified as large businesses, is totally inadequate in the IT industry. For whatever reason, SBA has clearly not done the kind of analysis needed to establish a reasonable dollar threshold beyond which small IT services firms became large business.

One-Tiered System Inadequate - Beyond SBA's inadequate analysis of the IT industry is another problem. The problem is that SBA has chosen for there to be one single cut-off point beyond which small IT services companies are treated as large businesses ($21 million in annual sales - three-year average). Beyond that point, they can no longer compete for Federal small business set-aside contracts.

In addition to failing to reflect the size that small IT services firms need to achieve to compete against large businesses, SBA's single-tiered system is an ineffective tool for ensuring competition between companies of approximately the same size. Historically, SBA could have established multiple tiers but, has not done so.

Small vs. Very Small - There are actually two sides to this size issue. One side is how can small businesses that grow beyond $21 million in annual sales compete against large business having sales in the hundreds of millions to billions of dollars per year in sales? The answer is: not very well.

There is a critically important flip side to this issue. That is: how can a very small IT firm (with annual sales of $500,000, for example), compete against small IT firms with years of experience in the Federal marketplace and annual sales approaching $21 million? The answer is… not very well.

Three-Tiered System for IT - To create a more level playing field in the IT services[1] industry, SBA should consider creating a multi-tiered system wherein companies of somewhat similar size compete against each other for federal small business set-aside contracts. One approach, to illustrate the multiple-tier concept, would be to create a three-tiered small business system consisting of:

1	Small Business - Tier I	Annual sales up to $5 million
2	Small Business - Tier II	Annual sales up to $25 million
3	Small Business - Tier III	Annual sales up to $100 million

Goal Structure for Multiple Tiers - For purposes of this discussion, the names and dollar sizes of the tiers is less important than the idea that:

1) The threshold beyond which small businesses in the IT services industry would be classified as large businesses is much more reflective of the size of the companies that small businesses would be competing against in of this industry; and,

2) Similarly sized small businesses within each of the three small business tiers would compete against each other for government contracts.

Under the multi-tiered approach, Government procurement officials would establish a goal structure designed to achieve an equitable distribution of small business contract awards among companies in all three small business tiers. Companies in each size category would compete against each other for contracts reserved for competition among firms in each of the categories under the small business set-aside program. Firms in the lower tiers could compete on set-asides in any tier. Firms in higher tiers could not compete on set-asides in lower tiers.

Ability to Compete in the Next Tier - As companies grow beyond their current tier threshold, they would have the ability to compete more effectively against firms in the next tier. Companies that grow out of Small Business Tier I (when sales exceed $5 million per year), for example, would have the ability to compete more effectively against Small Businesses in Tier II (that have sales in the $5 to $25 million dollar range).

[1] If the MBSC's 5-10-5 Formula is adopted, a five-tiered system would be recommended. The MBSC is submitting this document because it supports use of a multi-tiered system. However, the MBSC does not support the use of a 3-tiered system because in this instance small companies would not have the infrastructure to compete against 50 to 100 million dollar companies.

Companies that grow out of Small Business Tier II (when sales exceed $25 million per year) would have the ability to compete more effectively against Small Businesses in Tier III (that have sales in the $25 to $100 million dollar range).

Companies that grow completely out of the Small Business category (when sales exceed $100 million per year) would have a much better chance of competing against IT firms that have annual sales in the hundreds of million to billions of dollars.

More Equitable for Small IT Firms - Under a multi-tiered system, such as the one proposed herein, participation in federal contracting by IT firms would be based on competition between companies of roughly similar size. Small businesses of all sizes would be assured of a more fair opportunity to compete for federal small business set-aside contracts.

Precedent for Multiple Tiers - The problem that SBA has in establishing a single small-to-large threshold in an industry like IT services is that the sales range is from start-up companies having sales in the thousands of dollars annually to super giant companies having multiple billions of dollars in annual sales. How do you establish a single point of transition between small business and large business? The answer is that it is **<u>very difficult</u>**. That is one of the most powerful reasons for adopting a multi-tiered approach.

As discussed above, in having only one small business tier ($zero to $21 million), SBA is not adequately protecting the interest of small IT services companies in a marketplace dominated by large to super-large companies. Establishing a multiple tiered size standard system for the IT services industry would be one way to protect, support and nurture small IT firms, while creating a more level playing field for all small IT services firms in the federal marketplace.

Micro-Purchases - At the present time, the federal government actually does have multiple tiers in its contracting. At present, Federal procurements up to $2,500, called “Micro-Purchases,” are reserved for small business.

Small Business Reserve - By law, all Federal purchases valued between $2,500 and $100,000 are reserved for small businesses. The use of this authority applies when there are two or more "responsible" small businesses that can satisfy the agency's requirement at a fair market price.

The Very Small Businesses Set-aside Program - In addition, a number of years ago, the Congress directed the SBA to set up a pilot program that would set aside small contracts for “Very Small Businesses.” Under that program, requirements (including construction requirements) estimated to be between $2,500 and $50,000 would be set-aside for companies that had sales of $1 million or less, and 15 employees or less.

This Very Small Businesses program was implemented by SBA in several geographic areas on a pilot basis for a number of years. This program was for all government procurements (not just IT or any other single industry). The program reflected a clear sense in the Congress that a segment of the small business community was not adequately participating in Federal prime contracts.

COMMITS - Perhaps the best example of a multi-tiered approach to small business participation in government contracting is the COMMITS program at the U.S. Department of Commerce (DOC). Several years ago, top management at DOC determined that the agency was going to do a better job of assuring small businesses participation in departmental procurements, especially in the IT arena. To that end, DOC created the COMMITs GWAC.

Under the first round of the COMMITs GWAC, DOC limited competition to small, minority and woman-owned firms. Under this vehicle, COMMITs awarded 29 contracts to small, minority and woman-owned firms. This contracting vehicle was a means of ensuring that small businesses in the IT industry participated more equitably in DOC IT contracting.

COMMITS NextGen - More recently, in COMMITS NextGen, DOC established a more elaborate mechanism to ensure the participation of small businesses in the IT contracting activity of the Department. Under COMMITS NextGen, DOC established a three-tiered system for the participation of small businesses in DOC IT contracting. DOC does not formally refer to them as ***tiers***, but that is what they are in actuality. The breakdown of the three tiers is as follows:

Tier #1 - $6 Million or $12.5 Million

1. Small businesses certified at $6 million - $12.5 million size standards
2. Compete for COMMITS task orders of $5 million or less

Tier #2 - $21 Million or 500 Employees

1. Small businesses certified at $21 million or 500 employees or less
2. Compete for COMMITS task orders between $5 million and $40 million

Tier #3 - 1500 Employees

1. Small businesses certified at 1500 employees or less
2. Compete for COMMITS task orders from $40 million to $70 million

This three-tiered COMMITS system relied on SIC/NAICs Codes in three different areas to establish the three small business tiers. These were: IT size standards, Engineering Services size standards, and Telecommunications size standards. The underlying reason for the Engineering Services and Telecommunications size standards was that SBA did not have any size standards for small business IT services beyond $21 million.

The purpose of referencing the COMMITS model is not to say that it is an ideal system. The purpose is to illustrate that certain Federal agencies are already setting up and using a multi-tiered approach to securing small business participation in their IT services contracts.

Added Administrative Burden - The notion that a tiered approached represents an untenable additional administrative burden on Federal contracting offices was countered by the explanation that, under Commits NextGen, the assignment of contracting opportunities to the three tiers is simply a matter of a revenue cut-off. Task orders up to $5 million will be reserved for Tier #1 companies. Task orders up to $40 million will be reserved for Tier #2 companies (and Tier #1 companies that felt qualified to compete). Task orders up to $70 million will be reserved for Tier #3 companies (and Tier #1 and Tier #2 that felt qualified to compete).

What is the Underlying Goal? - The goal of most minority and small business organizations in the Federal marketplace has been to support policies that create the opportunity for minority and small businesses to participate more fairly in federal procurement. The underlying policy problem that we are dealing with in the IT industry is that the playing field is not level. Therefore, the system is not fair.

Unfair Size Competition - Small businesses and minority-owned firms simply cannot compete effectively against large majority companies having hundreds of millions to billions of dollars per year in sales. Just as importantly, <u>very</u> small firms cannot compete effectively against large <u>small</u> businesses having annual sales in the multiple millions of dollars.

Competition Between Similarly Sized Firms - How do we create a more level playing field so that small businesses can compete effectively in the federal marketplace? The answer is fairly simple. We can create a more level playing field by making certain that competition takes place among firms of roughly similar size. That can be accomplished by establishing a multi-tiered small business size standard system.

Small-to-Large Threshold - How do we establish a reasonable small-to-large business threshold in an industry that is comprised of companies having hundreds of thousands of dollars per year in sales to companies that have billions of dollars per year in sales? The answer is fairly simple. We can more adequately protect the interests of small IT services firms by establishing a multi-tiered small business size standard system.

Section II.

Arguments for and against the use of multiple tiers in the IT industry

At the January 4th meeting of the Size Standards Coalition, organized by the ABST and the Minority Business Summit, the vast overwhelming majority (easily 95%) of the 90 or so companies present at the meeting responded with a resounding yes to the question as to whether or not a multi-tiered system was desirable. Therefore, the First Section of this White Paper sought to lay out the rationale and an approach to a multi-tiered size standard system in the IT industry.

However, not all companies attending the meetings and participating in the discussions agree that a multi-tiered system is desirable. Some companies believe that moving to a multi-tiered system would adversely affect their position in the IT marketplace.

The purpose of this section (SECTION II.), therefore, is to try to articulate some of the pros and cons of this multi-tiered approach that have come up in the discussions following the January 4th meeting.

Some of the thoughts as to why a Multi-tiered approach would not work:

1. Such a system may be cumbersome and add significant admin burden to the SBA and the Federal Contracting offices
2. Such a system might not result in a net gain in contracts to small businesses
3. Such a system would result in many companies that are now quite large being put back in the small business set-aside system - if that were the case, the portion of the IT requirements that are now being secured by firms of $21 million of less could shrink dramatically

Some of the ideas as to why a Tiered approach could work:

1. The Department of Commerce is using such a tiered system in the Next Gen Commits program - this multi-tiered contracting approach will enable many more small businesses to participate in DOC contracting, and will increase the dollar value of contracts going to small businesses many times over
2. Certain agencies, such as the Food and Drug Administration, have been using a tiered system for years in making contracting decisions, with no added administrative burden
3. Federal contracting offices already go through a selection process to determine what contracts are suitable for 8(a)s, HUBZones, Vets, Small Business and large businesses - adding the process of placing small business contracts into the appropriate size categories would not be an onerous administrative burden.

Issues discussed

Administrative Burden on SBA - With respect to the thought expressed that a multi-tiered system would represent additional administrative burden on the SBA, several companies commented that they did not see a lot of additional burden being imposed. The Federal government has moved to a single source for reps and certifications (wherein companies would certify as to their size, among other matters). That source is the ORCA system wherein companies must update their company information yearly in order to maintain their eligibility to participate in government contracting.

The point was made that there is nothing additional for SBA to do as this would basically be a self-certification system. SBA would establish/define the tiers (whether revenue or employee-based), but would not be involved with each and every company in determining its size. That process would be handled through ORCA.

One of the participants indicated that the federal procuring offices always go through a process of determining which contracts are suitable for the 8(a) program, the HUB Zone program, the SDVets program, etc. Once those determinations are made, then the contract opportunities could be assigned into the appropriate size category and competition would take place for those contracts among companies in the appropriate tiers. This assignment process would not constitute an unmanageable added burden to the Federal procuring offices.

The notion that a Tiered approached represented an unwarranted additional administrative burden on Federal contracting offices was counteracted by the explanation that, under Commits NextGen, the assignment of contracting opportunities to the three tiers was simply a matter of a revenue cut-off. Contracts up to $5 million would be reserved for Tier #1 companies. Contracts up to $40 million would be reserved for Tier #2 companies (and Tier #1 companies that felt qualified to compete). Contracts up to $70 million would be reserved for Tier #3 companies (and Tier #1 and Tier #2 that felt qualified to compete).

The point was made that many task orders under existing GWACs and similar vehicles are presently beyond the reach of small businesses. The average task order under GSA's Millennia vehicle, for example, is $75 million. Under a Tiered System, small businesses would be able to compete for small business task order set-asides under such vehicles.

What kind of Tiers Make Sense - There were several proposals as to how many small business tiers there should be and what their size should be. One participant proposed a multi-tiered system of five tiers including: Tier #1 - Up to $3 million (or thereabouts) - - Tier #2 - Up to $25 million - - Tier #3 -Up to $50 million - - Tier #4 - Up to $90 million - - Tier #5 - up to 1500 employees.

Another participant described the thought process that went into establishing the three tiers in the COMMITS NextGen contracting vehicle. The process looked for natural breaks in size that made sense. The central idea was that there were issues of scale and size that related to capacity and infrastructure that were the main determinants as to the definition of the Tiers in Commits.

As more and more companies were consulted, a general schema emerged around which those who favor a tired approach seemed to be in fairly close alignment. There is nothing sacrosanct about these dollar thresholds set forth below for the various tiers. They could be modified so long as the idea of having multiple tiers is maintained.

1. Tier #1 - $3 million
2. Tier #2 - $15 million
3. Tier #3 - $40 million
4. Tier #4 - $100 million

Revenue or Employee Based Tiers - The issue of whether or not size should be determined based on revenues or employees was discussed at length.

One of the most critical issues relating to SBA's desire to create a simplified system based on numbers of employees is that there are a number of industries that, by their very nature, use a high percentage of part-time employees and independent contractors. The counting of all part-time people and independent contractors as part of the employee count (in an employee-based system), would be unfair, as it would artificially inflate the size of the business. This is akin to the situation of pass-through revenues of hardware resellers artificially inflating their revenues. It was suggested that a system of calculating the FT equivalent of these PT and independent contractors could be worked out based on the standard work-year of 2080 hours (or something along those lines).

Some companies favored a revenue-based system as being a lot simpler and more manageable. For companies, such as hardware re-sellers, which have lots of pass-through revenues, perhaps the SBA could be persuaded that such revenues should not be counted in size determinations.

The point was also made that companies need to be aware that in certain industries, like hardware resellers, a large part of their revenues that are essentially pass-troughs and artificially inflate the size of the companies.

How Small Business Sub-contracting Would be Affected - The question was asked as to whether or not the tiered approach would adversely affect the subcontracting program. In other words, would the primes have to make subcontracting decisions based on the multi-tied approach? Would that be a help or a hindrance? This is an important issue and there needs to be more discussion about it.

Capital-Intensive Industries - The issue was raised as to how the size standards would affect businesses with high capital requirements (such as companies in the defense and aerospace manufacturing industries) would be affect by size standards. Would revenue-based or employee-based size standards work better for them? No answers. More discussion needed.

<u>Other issues</u>

One of the comments focused on the issue of how to reward and incentivize federal contracting officers so that they were more responsive to the participation of small business in the contracting taking place at their offices (especially to get them do a better job in ensuring that small businesses participate in task order contracting under the various GWACs and similar type vehicles established for federal contracting). All too often, small businesses selected as primes on a GWACs (or similar vehicle) never secure any task orders because these small firms are forced to compete against large business for each task order under GWACs.

Three-Year Average - One of the participating companies indicated that another look should be taken as to whether or not a three-year average was appropriate in determining size. The suggestion as to why that might be inadequate was that it is often too small a timeframe for the size average to be accurate. It was further indicated that the three-year average is easily affected by contracting spikes, occasional pass-trough revenues, and other similar factor. The suggestion was made that it made more sense for size determinations be based on a 4 or 5 year average.

Excluding Controlled Small Businesses - One of the participating companies pointed out that many of the largest Federal prime contractors have created small companies that they own and control. The question was: what could be done to assure that such companies did not participate in set-aside opportunities that were meant for small, independent businesses?

No answers. More discussion needed.

Summary

These comments, with a willingness to work with SBA to fairly and equitably resolve some of the concerns are the intent of NMSDC.

If further elaboration is required or an interest in discussion of the above listed recommendation, please contact Steven Sims, Vice President, Government Relations, at 202 955-0036.

Sincerely,

Steven Sims
Vice President
NMSDC